

Turkey: Measured easing

Given the downside surprise in November inflation, improving inflation expectations, prevailing currency stability and low-interest rate environment, we expect the central bank to act, with a modest 100 basis point rate cut, pulling the policy rate down to 13% this month



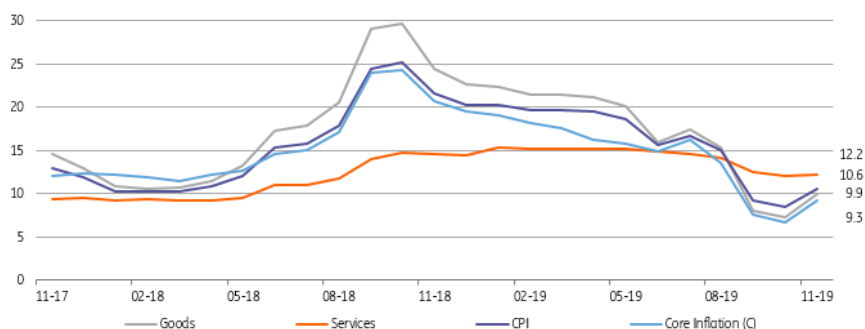
Governor of Central Bank of Turkey Murat Uysal

Source: Shutterstock

Turkey's central bank cut rates more than expected in October thanks to improving inflation and a better geopolitical outlook, which boosted sentiment. The question for the December MPC meeting is whether the bank will cut again and, if so, how far it will go.

The downside surprise in inflation last month has provided further room to act and inflation expectations continue to improve. In addition, the currency has been stable and interest rates remain low around the world. This suggests to us that the CBT will cut rates by a modest 100 basis points, pulling the policy rate down to 13%. Current market pricing implies a deeper cut but recent signs have pointed to a more measured pace of easing.

Inflation Outlook (%)



Source: TurkStat, ING

Inflation offers room to ease

In the latest inflation report released at the end of October, the forecast path was aligned with the one presented in the new economic programme, as the central bank revised its inflation forecasts to 12% for this year.

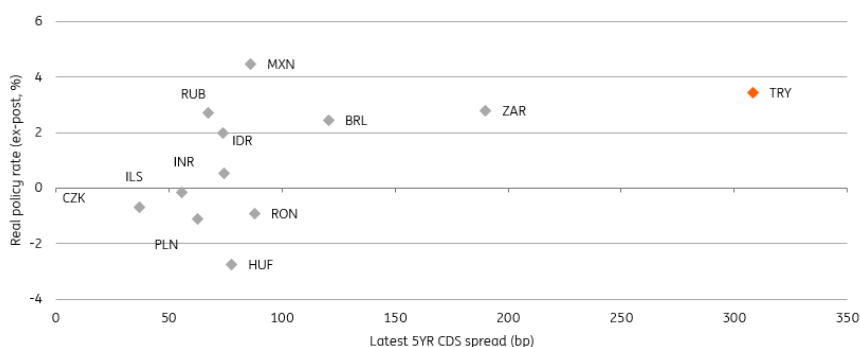
However, November inflation came in at 10.6% year-on-year, which was again lower than expected thanks to still-weak domestic demand, moderating pass-through and low cost push factors. This suggests that inflation will likely remain below the CBT's estimate for this year, encouraging the bank to continue its easing cycle at the last rate setting meeting of the year, despite the possibility of a further increase in December due to an unsupportive base. Also, the main policy guidance set out in the October interest rate announcement has remained unchanged from September. This suggests that the CBT will maintain its current stance at the forthcoming meeting.

In October, the CBT cut rates by 250 basis points, which was more than expected. But Governor Murat Uysal has since clarified the central bank's position, hinting at a more cautious policy stance going forward. Uysal stated that the bank has already used a significant part of the space available for loosening monetary policy, which implies that the front-loading of rate cuts seems to be over and further steps will be determined by the inflation path and market developments. Regarding the latest interest rate announcement in October, the CBT seemed confident about its policy moves as "the current monetary policy stance, to a large part, is considered to be consistent with the projected disinflation path", also signalling a more measured pace of easing in the remainder of 2019.

Other reasons for the CBT to be cautious are:

- The still-challenging inflation outlook; inflation expectations are not well anchored and there is high inertia especially in services inflation. There is also uncertainty surrounding the exchange rate path
- Fragile macro backdrop with ongoing high dollarisation as residents' FX deposits reached US\$194 billion and there is no meaningful improvement in the capital flow outlook so far while consumer confidence remains sluggish.

Real Policy Rate (ex-post) vs CDS premium



Source: Reuters, ING

The central bank has reiterated its commitment to a sustained disinflation process which will help reduce sovereign risk, lower long-term interest rates, and support a stronger economic recovery. This commitment also includes a positive ex-post real policy rate around 2% in the medium-to-long term, which is in line with Turkey’s long-term average. We expect the bank to continue cutting rates but at a slower pace. A 100 basis point cut this month should keep the real policy rate close to the average among emerging market peers and be broadly aligned with the CBT’s “reasonable” rate of the real return objective.

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